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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, MAY 24, 2002

COMMONWEALTH OF VIRGINIA

At the relation of the

STATE CORPORATION COMMISSION

CASE NO. PUE-2001-00306

Ex Parte: In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act

ORDER

By Order entered on March 27, 2002, the State Corporation Commission ("Commission") combined the outstanding fuel adjustment clause issues contained in Case Nos. PUE-2000-00583, PUE-2000-00746, PUE-2000-00748, PUE-2000-00749, PUE-2001-00001, PUE-2001-00002, PUE-2001-00004, PUE-2001-00005, PUE-2001-00006, PUE-2001-00007, PUE-2001-00008, and PUE-2001-00009 and the market price issues contained in the Virginia electric distribution cooperatives'¹ ("Cooperatives") Comprehensive Wires Charge Proposal ("Comprehensive Proposal") filed in the above-captioned case, and found that they should be addressed together in Case No. PUE-2001-00306.

¹ A&N Electric Cooperative, BARC Electric Cooperative, Central Virginia Electric Cooperative, Community Electric Cooperative, Craig-Botetourt Electric Cooperative, Mecklenburg Electric Cooperative, Northern Neck Electric Cooperative, Inc., Northern Virginia Electric Cooperative, Powell Valley Electric Cooperative, Prince George Electric Cooperative, Rappahannock Electric Cooperative, Shenandoah Valley Electric Cooperative, and Southside Electric Cooperative, Inc.

Briefly summarized, the Cooperatives propose that each cooperative's capped generation rate under § 56-582 of the Virginia Electric Utility Restructuring Act² ("Restructuring Act"), be comprised of the base generation rate approved in each functional separation case, together with

² Chapter 23 (§ 56-576, et seq.) of Title 56 of the Code of Virginia.

factors (plus or minus) reflecting wholesale power adjustments that each cooperative has been permitted to apply for decades. For purposes of simplicity in this Order, we will utilize the term "wholesale power adjustments" to refer to those adjustments the Cooperatives currently may make on a monthly basis through the application of wholesale power cost adjustment ("WPCA") or power cost adjustment ("PCA") clauses. It is these wholesale power adjustments that the Cooperatives propose to make to their base generation rates approved in their respective functional separation cases.³

In addition, the Cooperatives propose that for customers choosing alternative generation suppliers, the annually established market prices for generation would also be adjusted each month by the same increment as the monthly wholesale power adjustments described above. By making these two adjustments in parallel, the Cooperatives would keep their wires charges constant, thus avoiding conflict with the literal requirements of § 56-583 A while minimizing financial risk relative to the volatility of the wholesale market or the fuel components of purchases from that market. Section 56-583 A prohibits wires charges from being adjusted any more frequently than annually, and absent approval of the Cooperatives' proposal herein, the monthly wholesale power adjustments to these utilities' unbundled generation rates would run afoul of the provisions of § 56-583 A by causing monthly fluctuations in the wires charge.

Put simply, the Cooperatives' proposal is aimed at reconciling apparent tension between the provisions of § 56-582 B (generally permitting electric cooperatives' capped rates to be

³ The Cooperatives' proposal does not distinguish between those cooperatives that are power supply cooperative members (e.g., members of Old Dominion Electric Cooperative, or ODEC), and those that are not (e.g., the Craig-Botetourt, Central Virginia and Power Valley electric cooperatives). However, it is important to make that distinction for purposes of applying the capped rates provisions in § 56-582 of the Restructuring Act. In the case of distribution cooperatives that are members of power supply cooperatives, § 56-582 B(v) permits the adjustment of these cooperatives' capped rates to reflect changes in the fuel component of their wholesale power cost adjustment (WPCA) clauses. Cooperatives that are not members of power supply cooperatives, however, may flow any changes in the cost of purchased wholesale power through their capped rates under the authority of § 56-582 B(iv).

adjusted to reflect all or part of the changes in wholesale power costs) with that of § 56-583 A's requirement that wires charges be adjusted "not more frequently than annually." Section 56-583 A also directs this Commission to "seek to coordinate" annual adjustments to wires charges with adjustments to capped rates under § 56-582.

In accordance with § 56-583 A, wires charges must be determined annually by subtracting each cooperative's Commission-determined generation market price from that cooperative's then current unbundled generation rate that reflects those adjustments to wholesale power costs permitted under § 56-582 (See, footnote 3). However, as net purchasers of generation from the wholesale power market, each distribution cooperative's wholesale power costs may change on a monthly basis and these wholesale power adjustments are flowed through to retail customers on a monthly basis as well. These monthly adjustments effectively give each cooperative a floating capped generation rate, which might suggest that each cooperative's wires charges could or should be recalculated on a monthly basis as well because of the wires charge formula. As discussed above, however, § 56-583 A prohibits wires charges from being recalculated more frequently than annually.

Thus, the dilemma presented by the Cooperatives' unique circumstances is establishing for them the mandatory "annual" wires charges required by the Restructuring Act while simultaneously ensuring their ability to flow through wholesale power adjustments as authorized under that same act. At the same time, this Commission must consider the effect of the Cooperatives' proposed resolution of this problem on the development of competition within their service territories (a requirement imposed by the General Assembly under the provisions of § 56-596 A). Some might argue that if we allow the Cooperatives' market prices of generation to float in tandem with monthly adjustments to the Cooperatives' capped, unbundled generation

rates, competitive entry into such markets would be difficult since the "price to compare" in each cooperative's service territory would be a continually moving target.⁴

The March 27, 2002, Order permitted interested parties to file comments and/or requests for hearing on the Cooperatives' Comprehensive Proposal, including any comments on the Cooperatives' possible transition from a monthly fuel cost adjustment (embodying wholesale power adjustments) to an annual fuel factor. Additionally, the Order directed the Staff to file a report addressing the Comprehensive Proposal, its recommendation on possible transition to an annual fuel factor, and any comments received by interested parties; the Order also permitted the Cooperatives to respond to these filings.

On April 5, 2002, the Commission received comments from the Division of Consumer Counsel, Office of the Attorney General, ("Consumer Counsel"), Michel A. King on behalf of Old Mill Power Company ("Old Mill Power"), and AES NewEnergy, Inc. ("AES NewEnergy").

Consumer Counsel states that if the Commission finds that the monthly rate adjustments proposed by the Cooperatives in the Comprehensive Proposal are not in conflict with the Restructuring Act, it would not oppose the Cooperatives' use of this approach during the early stages of retail choice in Virginia. Consumer Counsel urges the Commission, however, to seek an alternative solution that will limit customer confusion and complexity so as to foster the development of a competitive market, without placing undue financial risk on the Cooperatives.

In its comments, Old Mill Power states that it: (i) supports the Cooperatives' approach for determining generation market prices except for the proposed adjustments for transmission and ancillary expenses; (ii) supports the Cooperatives' request to adjust capped generation rates monthly, while keeping wires charges constant, as a method for recovering wholesale power

⁴By comparison, Virginia's investor owned utilities' "prices to compare" provide fixed targets for competitive entry since fuel factor adjustments to their capped rates under § 56-582 B(i) are made no more frequently than annually.

costs and fuel costs from customers who receive bundled service without improperly charging these costs to customers who receive service from CSPs, on the condition that the Cooperatives agree to forego minimum stay provisions; (iii) opposes the Cooperatives' proposal to set wires charges at the time customer choice begins by adding the WPCA then in effect to the base generation rate approved by the Commission in each cooperative's functional unbundling case before subtracting base market prices; (iv) does not oppose the Cooperatives' proposal to present members with prices-to-compare that vary monthly; and, (v) opposes the collection of wires charges by the Cooperatives during any period in which they anticipate purchasing wholesale power under any type of agreement other than a "minimum take" agreement with unaffiliated third parties.

AES NewEnergy supports the Cooperatives' proposal to continue their current fuel adjustments on a monthly basis, but recommends that any minimum stay provisions for large customers be rejected until such time as the Cooperatives can demonstrate that "seasonal gaming" has occurred, and that the cooperatives serving that customer suffered financial harm as a result. Regarding the impact of the WPCA, AES NewEnergy recommends that a separate calculation of appropriately determined wires charges should be conducted each year, using forward prices for fuel and wholesale costs for the applicable forward period in order to eliminate any distortion of wires charge calculations. AES NewEnergy further recommends that the Cooperatives not be permitted to collect wires charges until 50% of their load has switched to competitive suppliers. Finally, AES NewEnergy recommends that any appropriate market pricing should be approved three months prior to July 1 of a given year, so that current market prices could be used in such calculations. According to AES NewEnergy, a revised filing should be made annually every January 1 reflecting forward market prices for 10 days over a six to eight

week period prior to January 1, so that by March 1, the Commission would approve these market rates, to be effective July 1 for the subsequent year. This timeline, states AES NewEnergy, provides an orderly transition to the July 1, 2007, date for elimination of any stranded cost recovery.

On April 12, 2002, the Staff filed its Report concerning the Cooperatives' Comprehensive Proposal and the comments received by the aforementioned parties. Staff stated that, at this stage in the development of competition in the electric industry, it supports the continued use of the monthly wholesale power adjustments as proposed by the Cooperatives. The Staff believes that the benefits of retaining this cost recovery mechanism for the cooperatives and their members outweigh disadvantages associated with a variable monthly price to compare. For the ODEC cooperatives,⁵ the Staff believes that the Cooperatives' proposal to use a current fuel factor as the fuel adjustment to generation for computing the annual wires charge should be modified to incorporate the current wholesale fuel adjustment from ODEC rather than the individual cooperative's current WPCA adjustment.

While the Staff's suggestion regarding the ODEC cooperatives may have merit, there are obstacles to its implementation. Staff's recommended use of ODEC fuel charges instead of individual cooperative WPCA factors is designed to place the calculations of Cooperatives' market prices and wires charges on a projected, forward-looking basis. However, and as discussed below, in its application this suggestion could be inconsistent with the requirements of the Restructuring Act's provisions governing wires charges (§ 56-583).

Section 56-583 A provides that each incumbent electric utility's capped rates (as further adjusted for fuel, taxes, etc. under § 56-582 B) may not exceed the sum of such utility's wires

⁵ All of Virginia's electric cooperatives except Central Virginia, Craig-Botetourt and Powell Valley Electric Cooperatives.

charges (as determined annually), unbundled charges for transmission and ancillary services, distribution rates, and Commission-established market prices for generation. Critical to the application of that formula, wires charges must be calculated using the same, unbundled, fuel-adjusted generation rate as that contained in the capped rate. Staff's proposal, however, would entail the use of different wholesale power adjustment indices (ODEC's for shopping customers, and WPCA factors for non-shopping ones), likely resulting in different unbundled generation rates for these two classes of customers—except in those instances when the two indices' wholesale power adjustments are, by happenstance, identical. In all likelihood, the use of different fuel indices would result in the capped rate being more or less than the sum of wires charges, unbundled charges for transmission and ancillary services, distribution rates, and Commission-established market prices for generation. Consequently, for that reason, it is our view that we cannot adopt the approach suggested by the Staff.

Taking all of the commenting parties' views into consideration, and with due regard to the Staff's conclusions and recommendations, for the purposes of concluding the Commission's first attempt at reconciling the many competing practical and policy issues presented by the Cooperatives' proposal, the Cooperatives' proposal to continue their current wholesale power adjustments on a monthly basis is approved. In addition, for the purpose of establishing wires charges for those cooperative customers choosing alternative generation suppliers, the annually established market prices for generation shall be adjusted monthly by the same increment as these monthly wholesale power adjustments, thereby maintaining each cooperative's wires charges at their approved annual levels. We note, as does the Consumer Counsel, that the Cooperatives' proposal comes in the early stages of Virginia's transition to retail choice. Consequently, this Commission and the Virginia General Assembly will have ample opportunity

to assess its impact, if any, on competitor entry into the Cooperatives' respective service territories.

In reaching this decision we have given due regard to the detailed comments of the parties participating in this proceeding, most of whom while generally supporting the Cooperatives' proposals, suggested certain conditions for this Commission's approval. In the case of AES NewEnergy, for example, support was offered for the proposal, with the recommendation that minimum stay provisions for large customers be rejected until such time as a cooperative demonstrates that "seasonal gaming" has occurred with resultant financial harm to the cooperative. However, the minimum stay rules we adopted last year⁶ require no showing of "gaming" or harm as a prerequisite to the initial implementation of minimum stay requirements. We will not seek to alter that policy as it concerns the Cooperatives in this Order.

In a similar vein, we will not adopt the recommendation of AES NewEnergy that no wires charges be collected by any cooperative until at least half of its customers have switched to competitive suppliers. The Virginia General Assembly in enacting § 56-583 established no such precondition, and we will not impose it by Order in this proceeding. With regard to AES NewEnergy's additional recommendations with respect to filings concerning forward market prices, etc., we will give them due consideration as we continue through the transition period that ends on July 1, 2007.

We have also considered the comments of Old Mill Power which offered many recommendations concerning the issues before us. Among other things, Old Mill Power suggests that the Commission's approval of the Cooperatives' proposal to adjust capped rates be

⁶ *Commonwealth of Virginia, ex. rel. State Corporation Commission, Ex Parte: In the matter of establishing rules and regulations pursuant to the Virginia Electric Utility Restructuring Act for customer minimum stay periods.* Case No. PUE010296, Final Order dated October 9, 2001.

conditioned on the Cooperatives' agreement to forego the minimum stay requirements established under our rules. These rules are not before us in this proceeding. As stated above, we will not seek to alter these rules as they pertain to the Cooperatives via this Order.

Old Mill Power also asks us to take actions that are not consistent with the provisions of § 56-583 with respect to its suggestion that Cooperatives be prohibited from collecting wires charges during any period in which they purchase wholesale power from any unaffiliated third parties except on a "minimum take" basis. Section 56-583 establishes no such limitation, and we will not seek to do so in this docket. We note, however, that Old Mill Power is generally supportive of the Cooperatives' position with respect to the monthly adjustment of generation rates to reflect changes in wholesale power costs (to the extent permitted by statute), and the corresponding proposal to modify the market price by identical increments.

We would also note that ideally, the Cooperatives would inaugurate retail choice in their respective service territories on the first day of a calendar year (i.e., January 1). This would place all of Virginia's incumbent electric utilities on the same schedule for purposes of establishing wires charges and "prices to compare"—a uniformity that could be valuable to competitive suppliers determining whether to enter or remain in the Virginia market. Neither the Restructuring Act nor our Order establishing the phase-in of retail choice⁷ for each incumbent utility imposes such a requirement. Consequently, each cooperative will determine when to open its retail market until January 1, 2004, when all incumbents' service territories must be open to retail choice.

As a starting point, those Cooperatives choosing to inaugurate retail choice mid-year, will be placed on their own, unique schedule for purposes of determining wires charges—at least

⁷ *Commonwealth of Virginia, ex. rel. State Corporation Commission, Ex Parte: In the matter concerning a draft plan for phase-in of retail electric competition*, Case No. PUE000740, Final Order dated March 30, 2001.

initially. Under § 56-583 A, wires charges cannot be changed any more frequently than annually. Consequently, if a cooperative inaugurates retail choice on July 1, 2002, for example, the first opportunity to adjust such charges would likely be July 1, 2003. Thus, it may be necessary to allow the initial wires charge to stay in place for periods greater than 12 months in order to place all utilities on a calendar year adjustment cycle. This should simplify marketers' decisions concerning whether to enter or remain in the Virginia market.

For purposes of calculating the Cooperatives' generation market prices, we will approve, at this time, the Cooperatives' proposal that this Commission utilize the basic methodology for calculating such prices approved for Virginia Power and AEP-Virginia in our Order in this docket dated November 19, 2001. Additionally, we note, as pointed out by the Cooperatives, that it may be appropriate to develop a modified methodology for purposes of setting such market prices for A&N Electric Cooperative in light of its location on the Delmarva Peninsula and its interconnection with PJM. However, the market price methodology we approve herein, generally, is subject to our continued review, and may be modified in the future.

Finally, and as discussed above, the Cooperatives' proposal we approve today, reflects wholesale power adjustments calculated on an historic basis (via WPCA clauses), and market prices determined on a projected, forward-looking basis. In the longer term, these two components of the Cooperatives' wires charge calculations should be synchronized. We agree with Consumer Counsel that ultimately our goal is to find a solution limiting customer confusion, reducing complexity, and fostering the development of a competitive market, without placing undue financial risk on the Cooperatives. To that end, the Cooperatives, interested parties and the Staff are directed to continue their examination of the use of wholesale power adjustments based on projected (versus historic) costs for the Cooperatives and to address this

issue once again as and when the Cooperatives' market prices and wires charges are under consideration.

Accordingly, IT IS ORDERED THAT:

(1) The Cooperatives' capped, unbundled generation rates shall, in the case of those cooperatives that are not members of power supply cooperatives, be adjusted monthly to reflect the cost of purchased wholesale power pursuant to the provisions of § 56-582 B(iv);

(2) The Cooperatives' capped, unbundled generation rates shall, in the case of those cooperatives that are members of power supply cooperatives, be adjusted monthly to effect the recovery of fuel costs through the application of their wholesale power cost adjustment clauses of their respective tariffs, pursuant to the provisions of § 56-582 B(v);

(3) For purposes of calculating wires charges pursuant to § 56-583, for those Cooperative customers selecting alternative generation suppliers, the projected market price for generation shall be simultaneously adjusted by an increment equal to any monthly adjustments authorized under Ordering Paragraphs (1) or (2) herein, thereby maintaining such wires charges at their authorized levels.

(4) The Cooperatives' market price for generation shall be that established by the Commission consistent with the methodology approved by this Commission for Virginia Power and AEP-Virginia in our November 19, 2001, Order in this docket, subject to such changes in the future as may be warranted. Such methodology may, however, be modified to address special circumstances, as discussed in this Order.

(5) For Cooperatives commencing to offer retail choice at times other January 1, 2003, or January 1, 2004, such cooperatives' market price for generation shall be that established by the Commission consistent with the methodology set forth in Ordering Paragraph (4), subject

to such updating as the Commission may require. Additionally, for such cooperatives that are members of power supply cooperatives, the initial wholesale power adjustment to their approved, unbundled generation rate shall be their then current WPCA factor. For cooperatives that are not members of power supply cooperatives, the initial wholesale power adjustment to their approved, unbundled generation rates shall be their then current wholesale power cost adjustment ("WPCA") or power cost adjustment ("PCA") factor. Subsequent wires charges as then initially established will remain in effect for at least twelve months thereafter in accordance with the provisions of § 56-583 A.

- (6) This case is continued for further orders of the Commission.